The American Consumer Institute

November 20, 2007

Marlene Dortch, Esq.
Secretary
Federal Communications Commission
445 12th St., S.W.
Washington, DC 20554

Re: Ex Parte Letter Submission in MB Docket No. 07-42

Dear Ms. Dortch:

The American Consumer Institute is submitting this letter ex parte in response to the Commission's Notice of Proposed Rulemaking in the Matter of Leased Commercial Access and Development of Competition and Diversity in Video Programming Distribution and Carriage (MB Docket # 07-42).

The American Consumer Institute is an independent organization founded in 2005. The Institute's mission is to identify, analyze and project the interests of consumers in selected legislative and rulemaking proceedings in information technology, health care, insurance and other matters. Recognizing that consumers' interests can be variously defined and estimated, and that numerous parties purport to speak on behalf of consumers, the goal of the Institute is to bring to bear the tools of economic and consumer welfare analyses as rigorous as available data allows, while taking care to assure that the analyses reflect relevant and significant costs and benefits borne by, or created for, consumers.

In a mixed economy consumers are dependent for their collective welfare on intelligent use of their own resources, on competitive market forces and on government action. The record in this proceeding provides compelling evidence that market forces acting on integrated cable system operators (i.e., operators that both own the cable distribution systems themselves and own cable programming businesses as well) are not adequate to assure consumers of the choice and quality of programming made possible by technology and real costs of production, and that government actions to date have not sufficiently offset this market failure.

The purpose of this submission is to urge the Commission to protect consumers' interest in program diversity by adopting, as a standing remedy available in all program carriage disputes, a version of the dispute settlement rules established for a narrower class of carriage disputes in the Adelphia proceeding. Those rules made available, and set forth terms defining, a form of *final offer* arbitration (also known as *baseball-style* arbitration) in any disputes involving regional sports networks (RSNs).[1] In support of that recommendation, the comments articulate more explicitly a consumer perspective on pivotal issues raised in the debate over competition, carriage and diversity in cable program distribution. They highlight evidence of market failure that cumulatively justify ameliorative government action.

Part I below defines the nature of consumers' interest and establishes why *final offer* arbitration addresses consumers' needs better than current procedures. Part II reviews indicators and sources underlying the failure of markets to protect consumers, the reasons behind this market failure, and why current Commission rules are falling short of Congressional purpose. Part III concludes with the American Consumer Institute's recommendations for remedial Commission action.

I. CONSUMERS AND *FINAL OFFER* ARBITRATION

On initiating this Rule Making, the Commission declared its intention to focus on the program carriage complaint process as a means of enabling and helping to assure the availability of diverse programming to American consumers.[2] The Cable Television and Consumer Protection Act of 1992 makes unambiguously clear the Commission's obligation and authority to do so.[3] The Commission's carriage complaint process provides the principal means of resolving market-place disputes between integrated program distributors/producers and independent program providers seeking carriage. Outcomes of the process directly and significantly affect the level and distribution of economic welfare consumers derive from watching programming available over cable networks.

<u>Consumer Welfare, Cable Carriage and Timely Dispute Resolution.</u> Consumers' interest in the types and diversity of programming to which they have access translates to a substantial stake in the outcome of negotiations among suppliers and distributors of programming and to a stake in the efficacy of government processes addressing market failures. Consumers have an important derivative interest in the speed with which these determinations are made. Just as justice delayed may be justice denied, so it is with delays in resolving disputes that have the practical effect of delaying, distorting or denying consumer's access to preferred programming.

Consumers' stake in the outcome of this proceeding is large by available measures. They spend over 4 hours a day -- the equivalent of two months out of every year -- watching TV.[4] According to the American Association for Retired Persons, senior citizens average five and a half hours per day.[5] As reflected by the number of consumers with cable connections and their

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[1] Applications for Consent to the Assignment and/or Transfer of Control of Licenses, Adelphia Comm. Corp., Assignors to Time Warner Cable, Inc., et al., Memorandum Opinion and Order, MB Docket No. 05-192, 21 FCC Rcd. 8203, 8287 at ¶ 190-91, Appendices B (rel. July 21, 2006) ("Adelphia").
[2] *Leased Commercial Access: Development of Competition & Diversity in Video Programming Distribution & Carriage*, Notice of Proposed Rulemaking, MB Docket No. 07-42, FCC 07-18.
[3] *See, for example*, Communications Act §§ 616 and 628 (47 U.S.C. §536 and 548).
[4] <u>Television and Health</u>, Web Page of Dr. Norman Herr. Online at: http://www.csun.edu/~vceed002/health/docs/tv&health.html#tv_stats.
[5] Lavada DeSalles, *Preparing Consumers for the End of the Digital Television Transition*, AARP's Testimony Before the House Subcommittee on Telecommunications and the Internet of the House Committee on Energy and Commerce, AARP, Washington, DC, March 10, 2005. For elaboration of consumers' stake in cable programming, see: Steve Pociask, *An Analysis of Cable TV Services: Are Older Consumers Losing Out?*, The American Consumer Institute, October 17, 2005. Online at: http://www.theamericanconsumer.org/cable.pdf.

program choices, much of that time is spent tuned to a cable channel.[6] Cable is an important source of news and other specialized programming valued by consumers.[7] For much of this specialized programming, cable television is the optimum distribution channel, as the programming is not of sufficiently broad interest to justify full-time carriage on major broadcast networks, yet can be easily found and viewed by interested consumers when included in diversified cable channel packages.

Consumers spend a significant share of their income on cable television services and television equipment. According to Consumer Expenditure Surveys done by the U.S. Bureau of Labor Statistics, spending per household on cable television service amounted in 2005 to about $520 per year. Seniors in the 65-74 age group spent even more.[8] Average expenditure is well over 1% of average household income and a substantially higher share for households headed by seniors or below average income consumers. The average household spent another $105 on television equipment. As measured by overall consumer expenditure, share of income, or time devoted to it, cable television service is an important element of consumers' individual and collective well-being.

Consumers have other news, educational, public interest, and entertainment programming alternatives available, but cable television service is a dominant or principal source for many consumers. The range of program choices available to consumers is determined in large part by cable companies who also own (both individually and as a group) significant shares of the programming they carry. Congress has passed laws, enforced by the Federal Communications Commission, designed to make sure that Americans have access to diverse program sources and in particular to programming in which cable television companies do not have an economic interest. But market forces at work and as currently constrained and shaped by Commission rules are not affording adequate protection to consumers' interests.

Consumer Benefits of *Final Offer* Arbitration.[9] Numerous, diverse dispute resolution methods are available.[10] Each has distinctive legal, economic and political

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[6] A recent study indicates that Americans in 2007 spent 1,555 hours watching television a modest increase from 1,467 hours in 2000. The estimate apportioned 678 hours to broadcast television and 877 to cable and satellite television. *Study of Americans' Media Use Finds Web Finally Passing Newspapers*, reported by the Associated Press, December 16, 2006. Online at: http://www.prisonplanet.com/articles/december2006/161206Web.htm. For the importance of cable viewing more generally, see, *In the Matter of Federal Communications Commission, Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, MB Docket No. 05-255, Twelfth Annual Report, March 3, 2006, ¶ ¶ 27-40. Online at: http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-06-11A1.doc.

[7] Project for Excellence in Journalism, *2007 State of the News Media Report*, March 12, 2007. Online at: http://journalism.org/node/7020.

[8] Bureau of Labor Statistics, *Consumer Expenditure Survey*, Tables 1202 and 1300, 2005.

[9] We prefer the term *final offer* arbitration, which may be referenced differently in a particular setting. The reference to *baseball* arbitration derives from the use of *final offer* arbitration as means of settling salary disputes between owners and baseball players. See discussions in Rodney D. Fort , Sports Economics, Prentice Hall, Upper saddle River NJ, 2006, p. 296; Michael Leeds and Peter von Alleman, The Economics of Sports, Addison Wesley, Boston, 2008, p. 267.

[10] For a survey of uses in different arenas and assessment of the relative advantages and disadvantages of various methods, see Dennis Campbell, Dispute Resolution Methods, Aspen Publishers, 2007 and Henry S. Farber, *An Analysis of Final-Offer Arbitration*, Journal of Conflict Resolution, December vol. 24, no.4, 1980, pp.683-705. We note as well the growing interest reflected in the economics literature of alternative dispute resolution methods in traditional public interest oriented regulatory contexts. The interest grows

characteristics that combine to create differential (dis)advantages in particular contexts. In the Adelphia proceeding, the Commission drew from its News-Corp.-Hughes Order and imposed a remedy to market failures that requires parties to submit to arbitration. Any party who otherwise would be a complainant before the Commission was enabled "…in lieu of filing a program carriage complaint with the Commission to submit its claims to arbitration." The Commission emphasized then the importance to consumers of timely resolution of carriage disputes and in particular those that involve seasonal programming – sports in particular.[11]

The form of *final offer* arbitration prescribed in the Adelphia proceeding has numerous advantages relative to other methods of resolving disputes over whether and under what conditions independent program suppliers gain access to cable distribution facilities. Specific details needed to implement *final offer* arbitration vary in practice, but the central features are requirements: a) that each party submit its final offer to the arbitrator, along with support for its claims on the offer's behalf, and b) that the arbitrator choose one or the other of the offers, unchanged and in its entirety. Put negatively, the parties are not permitted to posture and change positions, nor is the arbitrator permitted to mediate, to pick and choose from elements of the two offers, or to alter the offers in any way. The outcome is binary -- a winning offer and a losing offer.

There are several legs to the case for extending more broadly the imposition of the baseball-style arbitration requirement prescribed by the Commission for RSNs in the Adelphia proceeding. The most notable, but by no means the only, advantage is inherent in the incentive structure imposed on parties that heretofore were unable for whatever reason to reach any agreement, never mind one that advanced the interests of consumers. *Final offer* arbitration also eliminates differences in market power and financial resources between the parties and puts the parties on more nearly equal footing. It shortens the time needed to resolve disputes and thereby accelerates consumer receipt of the benefits from agreement. *Final offer* arbitration eliminates benefits to either party and associated costs to consumers, of delay, obfuscation, refusals to deal or bargain in good faith, and

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out of the even larger literature documenting the costs of market failure and incompletely successful government efforts to offset or remedy them. (See note 17 below.) For an extensive review of different forms of arbitration in settling disputes in utility rate cases see, Zhongmin Wang, *Settling Utility Rate Cases: An Alternative Ratemaking Procedure*, Journal of Regulatory Economics, volume 26, number 2, September, 2004. Wang focuses on issues and methods used at the U.S. Federal Energy Regulatory Commission, but also includes an extensive bibliography to other jurisdictions and negotiation/arbitration methods. Doucent and Littlechild set out the economic case for settlements among the parties and his discussion calls attention to a variety of benefits from arbitration in general, as a substitute for traditional regulatory processes. He specifically cites improved incentive structures, time to resolution, reduction in complexity and economy. See, Joseph Doucet and Stephen Littlechild, *Negotiated Settlements: The Development of Legal and Economic Thinking*, Utilities Policy, 4 (2006), 266-77. Morgan notes widespread agreement that "…something is wrong with much of the procedure of regulation especially the complexity and sheer time consumed." Morgan also advocates a view embraced by the American Consumer Institute in this proceeding to the effect that regulators should be viewed as agents who provide means to help parties work out arrangements that advance the public interest. See, T.D. Morgan, *Towards a Revised Strategy for Ratemaking*, University of Illinois Law Forum, 1, (1978), 21-78.

[11] Adelphia Order, p. 87.

other tactics that thwart agreement.[12]

Further, *final offer* arbitration will eliminate the exercise of monopsony power (buying power) owing to either party's control over valuable assets – either distribution networks or specialized content – and, as a result, offers assurances that consumers will not be forced to pay for exercise of that power in the form of higher prices, lower quality programming and/or fewer options.

An ironic benefit of compulsory *final offer* arbitration would likely be diminished use of the process in the long run, as a result of firms finding it advantageous to negotiate settlements rather than to "roll the dice" and risk losing in an all-or-nothing venture.

In time the results of previous arbitrations will become widely known and provide parties with guidance on the four corners of offers likely to be accepted or rejected by arbitrators. That process should yield a set of *de facto* rules that, taken together, will effectively define "fair market value" agreements and, through that, generate such *de facto* rules, increase the prospect for successful negotiations, and decrease the need and complexity of *final offer* arbitration if and when a party demands it.[13]

Use of *final offer* arbitration will be more economical in the sense that it will require fewer resources from the parties that rely on the FCC's complaint processes. The process will benefit large and small independent programmers who will be relieved of the need to prove violations of the law by cable operators. They will no longer have to meet difficult burdens of proof of discrimination that often require information to which they have no access. Instead the *final offer* arbitration process permits them to use scarce resources on the task of quantifying and otherwise proving to an arbitrator why awarding them access to cable facilities is warranted by the value of the programming they wish to offer to consumers. *Final offer* arbitration shifts the focus of public policy to solutions, timely and economic solutions, and away from fault finding, proof, and time-consuming, litigation, disputation and adjudicatory decision-making.

The process similarly relieves the Commission of the need to use up scarce public and private resources in efforts to fashion legally sustainable rules addressing the "tariff-like" details of program carriage agreements – rates, terms of service, etc. The history of Commission regulation of "carriage" rates and terms of services is not encouraging in

[12] Resolution of the conflict "…can be crucial not only to the parties themselves, but also in some contexts to prevent further loss of welfare of other stakeholders who are not party to the dispute but are affected by it (such as consumers or the products/services produced [by the firms in the dispute.] Further, arbitration "…enhances the likelihood of reaching an agreement with minimal delay and minimal cost. As such, this mechanism…is of interest to society at large which cares about the welfare of its citizens." These conclusions follow a much broader analysis by Yannick Gabuthy and Abhinay Muthoo, *Arbitration and Investment Incentives*, March 10, 2005, p. 2. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=891105

[13] Migration to a situation where arbitrations are no longer required is more nearly assured and accelerated by readily available and accurate information about the details of prior arbitrations. That raises the question as to the proprietary nature of data submitted to the arbitrator and more importantly focuses on whether or not the Commission ought to require full disclosure. While important, that issue is beyond the scope of this letter.

this regard. Indeed the Commission has in recent years and on several fronts found it consistent with the public interest to wind down intrusive, time-consuming, and costly adjudicatory processes and to rely on alternative, more efficient and effective mechanisms.

Cable operators oppose *final offer* arbitration, but consumer advocates find their arguments less than compelling and not at all responsive to consumer concerns. For example, Comcast claims that the FCC is foreclosed from mandating *final offer* arbitration, since "…an agency is directed not to use means of alternative dispute resolution where 'the matter significantly affects persons or organizations who are not parties to the proceeding.'"[14] Acceptance of that line of reasoning as a general rule would effectively estop virtually all FCC rulemaking.[15] But, the current impasse in successfully negotiating carriage agreements has a substantial negative welfare impact on consumers of cable services who are not parties to the negotiations.

Comcast's assertion that the role of administrative adjudication in providing guidance for future conduct and adjudications would be "hamstrung by using arbitration" is also without merit. It ignores the very important role experience and economic information from the record of prior arbitrations would have on the initial offers of parties and their perceptions of offers-likely-to-win in future arbitration. Information from past arbitrations, including the results of FCC review, would create precedential value by influencing the decisions of future arbitrators. Over time the weight of past awards would combine to create precedent, provide more information to inform private negotiations, reduce the number and complexity of disputes to be arbitrated, and very importantly, provide transparent pricing information that ultimately can benefit consumers. Finally, Comcast ignores the Commission's rules in the MASN matter respecting Commission and judicial review of the awards of arbitrators.[16]

II. INDICATIONS OF MARKET FAILURE AND CONSUMER HARM

It is well established in consumer welfare economics and widely accepted among policy makers that government has a role and obligation to intervene a) when there is clear evidence of market failure and b) in circumstances where the potential costs of intervention do not outweigh the likely benefits. The general rationale for allowing markets to work and minimizing government interference is that decisions made on the

[14] Citing 5 U.S.C. ¶ 572(b)(4).
[15] Comcast elaborates and notes further that, "An arbitrator's decision that would require carriage of a particular channel could result in other channels being dropped, adversely affecting third parties in contravention of the directives of the statute." See, Comcast Comments, page 36, Note 93. This begs, or prejudges, the principal issue in this proceeding, consumer access to content, while asserting again a legal interpretation that on its face would effectively strip the Commission of all rulemaking authority.
[16] See Appendix B, Part 4 in the Adelphia Order. "A party aggrieved by the arbitrator's award may file with the Commission a petition seeking de novo review of the award…The Commission shall issue its findings and conclusions…judgment upon an award by the arbitrator may be entered by any court having competent jurisdiction over the matter."

basis of private costs and benefits more or less mirror social costs and benefits.[17] There are clear indications here that markets are not working to maximize consumer welfare in market-driven cable programming decisions.

Consumer welfare economics recognizes not only the potential for markets to fail to serve consumers' interests, but also identifies the sources of such failure that may provide a rationale for government restraints on, or assistance to, Adam Smith's "Invisible Hand" as a means of protecting them.[18] The record establishes the presence of market failures and provides indicators that justify government action. The record also provides guidance as to the most beneficial application of government action.

Consumers are best served when decisions are made on the basis of private costs and benefits that also reflect public values. There is often incongruence between private and public benefits from economic decisions. That is the case here. The record contains strong indications of substantial divergences between private, corporate benefits and public, consumer benefits resulting from program carriage decisions made by integrated cable operators who own both distribution facilities and program content. Externalities are signaled by the fact that carrying programs of affiliated interest will likely generate greater profits for cable companies than carrying programs valued more highly by consumers, but produced by unaffiliated rivals of cable affiliated program suppliers.

If firms have market power, a second source of market failure, they can decide on the basis of private benefits rather than public benefits, and do so by discriminating against independent program suppliers in which they have no ownership or other commercial interest.

The record is replete with unrebutted and largely uncontested indications of the exercise of market power by integrated cable/program suppliers via discrimination against independent program suppliers.[19] While differentiation in terms, product

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[17] There is abundant literature on sources of market failure and related costs and benefits of remedial government actions. The American Consumer Institute has found some to be particularly useful to efforts to balance market failures and the costs of government attempts to offset them. See, Francis M. Bator, *The Anatomy of Market Failure*, Quarterly Journal of Economics, 72, August 1958, pp. 351-379; William J. Baumol, Welfare Economics and the Theory of the State, rev. 2nd ed. Harvard Univ. Press, Cambridge, 1965, pp. Tevnik F. Nas, Cost-Benefit Analysis: Theory and Application, Sage Publications, London, 1996; Gordon Tullock, Arthur Seldon, and Gordon L. Brady, Government Failure: A Primer in Public Choice, Cato Institute, Washington, DC, 2002; William C. Mitchell and Randy T. Simmons, Beyond Politics: Markets, Welfare, and the Failure of Bureaucracy, Westview Press, San Francisco and Oxford, 1994. All emphasize benefit-cost analysis of both market and government imperfections.

[18] Analysts cite different failures and group them in different ways, but the following is both a representative and useful list of such failures: a) the presence of externalities, b) presence of public goods, c) imperfect competition in constraining the exercise of market power, d) imperfect, inadequate information, e) transactions costs, and f) distributional inequities. See Mitchell and Simmons, Beyond Politics: Markets, Welfare, and the Failure of Bureaucracy, esp. chapter 1, *Market Failure and Government Intervention: The View from Welfare Economics*.

[19] Letter to Marlene Dortch from America Channel in MB Docket No. 07-42, pp. 1-7 summarizes many of the details of practices by integrated cable operators cited by others in the record. The practices range from imposition of a variety of conditions precedent to the willingness of the operator to carry independent programming. See also comments of NAMAC and those of the Black Television News Channel

characteristics, prices and other elements of marketplace offers are commonplace and not *per se* objectionable, differentiation in terms based solely, or substantially, on the affiliation of a customer or supplier, and without regard to comparative merits, is not in the consumers' interest.[20] It very likely deprives consumers of options they might well choose were they given the opportunity to do so.

To illustrate these points, we examined and analyzed further evidence introduced by Hallmark Channel comparing fees paid by cable operators to different suppliers (an indicator of the value cable operators associated with the programming) to the Nielsen ratings for those same programming services (an indicator of public or consumer value assigned to the same programming). The differences establish the presence and scope of discrimination by Time Warner and Comcast in favor of their own affiliated programming services and against that of Hallmark. Discrimination is reflected in a comparison of a) fees paid for and b) audience attracted by affiliated vs. nonaffiliated programming.

Conceding at the outset the presence of multiple factors underlying license fees paid program suppliers by cable operators, the major element of the value of different channels is, nevertheless, the number of viewers. Consumers vote with their eyes and the attention they pay to and for different programs. Although license fees are not expected to be precisely proportional to households watching a channel (viewer demographics can also be a key driver of the value of a particular channel), there is no basis for supposing that *ownership* of a channel should be a more important determinant of value than the audiences it attracts. Yet, that is precisely what Hallmark's data show.

Hallmark Channel receives from cable operators, on average, three cents ($0.03) per cable subscriber for programming that is accorded by Nielsen a Prime Time Household rating of 1.1, which is defined by Nielsen as the "estimated percentage of the universe of TV households tuned to a program in the average minute."[21] Concurrently (measured in April, 2007), Time Warner paid its CNN affiliate 44 cents (more than 14 times the average fee paid to Hallmark) for programming that attracted a Nielsen rating of 0.7. Thus, Time Warner paid its affiliate a fee 14 times greater for a prime time audience about 2/3 as great. Similarly, Comcast paid its affiliate (*G4 videogame tv*) twice as much for 20 percent of the audience attracted by Hallmark. In another case Comcast paid its affiliated Golf Channel more than seven times the fee paid Hallmark, but for an audience less than twenty percent of the number of Hallmarks' average prime time household viewers.

Since most carriage agreements contain so-called "most favored nation" clauses leading to price uniformity among major cable systems for a particular channel or

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[20] Price and service differentiation (*discrimination)* based on acceptable economic differences are often beneficial and create value for consumers. See Larry F. Darby, *FAQs about Price Discrimination and Consumer Welfare*, ACI Consumer Gram. Available at: http://www.aci-citizenresearch.org/discrim.pdf .

[21] Nielsen Media Research, *Stats and Calculations; Acronyms and Glossary. O*nline at: http://www.nielsenmedia.com/nc/portal/site/Public/menuitem.f4d5649ee76b5f8202a7111047a062a0/?vgnextoid=c74042ab76795010VgnVCM100000880a260aRCRD&vgnextrefresh=1

program source (i.e., such clauses lead Time Warner Cable to pay the same as Comcast for Comcast-owned channels, and vice versa; and lead all cable companies to pay similar prices for independent channels as well), the Hallmark data are likely to reflect closely the industry-wide structure and level of fees in carriage contracts for cable company-affiliated channels, as well as for independents.

The table below generalizes these comparisons across all programs in the Hallmark exhibit. The table is derived from Hallmark data on fees paid for, and household audiences attracted by, different program services. It shows first the results of dividing the average license fee paid to programmers by the program's Nielsen audience rating. That is a proxy for "price paid per viewer" in either prime time or average day time for different services. Secondly, it expresses these proxies for prices paid per viewer for different services as a multiple of the price paid to Hallmark, the independent, non-affiliated program supplier.

The last two columns indicate multiples of fees paid per viewer for affiliated programming versus fees paid per viewer for the independent programmer. In *all* cases the multiple exceeds three and ranges frequently into the twenties and beyond. The multiples indicate the premium paid to affiliates, but they are also a compelling measure of the degree of discrimination against non-affiliated programmers. The record contains no consumer-oriented or demographic explanation of these multiples or evidence suggesting anything but a reflection of systematic discrimination in favor of affiliated program suppliers.

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MEASURING DISCRIMINATION
FEE DIFFERENTIALS FOR
AFFILIATED VERSUS INDEPENDENT PROGRAM CONTENT

CHANNEL	Affiliation	Fee per Prime Time Rating Point	Fee per Total Day Rating Point	Prime Time Payment Multiple	Day Time Payment Multiple
TNT	TW	0.49	0.81	18X	22X
CNN	TW	0.63	0.88	23X	23X
TBS	TW	0.33	0.54	12X	12X
Golf Channel	Comcast	1.15	2.30	42X	14X
E!	Comcast	0.50	0.67	18X	18X
Cartoon Network	TW	0.13	0.15	5X	4X
style.	Comcast	0.60	1.20	22X	32X
Court TV	TW	0.08	0.10	3X	3X
G4 Video Game	Comcast	0.30	0.60	11X	16X
Hallmark Channel	Independent.	0.03	0.04	1X	1X

Source: Calculated by American Consumer Institute from data in the record submitted by Hallmark.

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There are other examples in the record, but the pattern is clear.[22] Even granting some merit to the presence of transactions cost savings in dealing with affiliates vis-à-vis independents, relative differences in prices paid here are better explained as the result of anticompetitive discrimination against independent programmers.[23] It is notable as well that these fees are negotiated and established in long term contracts and do not reflect the number of actual viewers. Thus, a popular independent channel with growing popularity among viewers is unlikely to enjoy growing compensation to reflect its increased value to consumers *and* profit for the cable operator.

The foregoing makes clear the presence of discrimination against independent programmers. But, it does not indicate why consumers should care how the money they pay to cable operators is divided among different program suppliers. Consumer welfare is implicated for several reasons. First, to the extent that the Hallmark comparison is representative of discrimination more generally against independent program suppliers, the practice will suppress development of alternative program sources, as well as competition for the programming of the integrated suppliers. Programming is expensive and risky. It is attractive to investors in accordance with expected revenue and profit.

Suppression of fees and revenues for independents reduces alternative programming supply sources and with that reduced competition to integrated producers. Fewer resources from established independent programmers and potential entrants will be devoted to program production. If revenues are insufficient to compensate for risk and uncertainty inherent in new ideas, new approaches and new programs, the sector will tend to stagnate and contract.[24] The concomitant result to weakened independent production is of course increased market power for affiliated producers, which market power can be expected to result in higher prices and less program diversity and quality over time – in clear contravention of Congressional concern, expressed in the Cable Acts of 1992 and 1984, for protecting program diversity.

Concern for growth prospects and indeed the very survival of an independent program production sector is more than academic. Independent programmers are trapped in a vise created by cable system operators who, on the one hand, dictate low revenue streams for independent producers while, on the other, imposing "funding requirements" as necessary conditions to be included in carriage agreements with them. The Black

[22] American Consumer Institute analysis of Nielsen ratings of top cable programs for the five year period 2002-2006 inclusive indicates that the top 10 shows; 24 of the top 25 shows; 42 of the top 50 shows; and 64 of the top 100 shows were programs of the same type as those produced by another nonaffiliated program supplier, the NFL Network Service, which is currently being denied broad distribution by integrated cable operators.

[23] Transactions costs reflect differences in the cost of exchanges within a firm compared to the cost of exchanges between firms. Transactions within a firm, between entities with common objectives, are typically easier than doing deals among between firms with conflicting goals.

[24] Not all consumers watch all programs. According to the GAO, "Under the current approach, it is likely that many subscribers are receiving cable networks that they do not watch." Programs may be of significant interest to small subsets of viewers, but are in the aggregate of marginal value to all American consumers. GAO indicated as much and observed that: "…a 2000 Nielsen Media Research Report indicated that households receiving more than 70 networks only watch, on average, about 17 of these networks." GAO Report at 31.

Television News Channel calls attention to the difficulty for independents to secure funding a) from capital markets, or b) from cash generated by carriage on cable systems other than those of Time Warner and Comcast, if such independents do not have carriage deals with Time Warner and Comcast.[25]

In competitive markets not distorted by market power, independent networks would be evaluated by investors and providers of other resources, including talent, according to the quality of their content, price and potential consumer demand. Not so here, inasmuch as investors look first and in substantial measure to the strength of existing distribution agreements or, as here, the difficulty of obtaining favorable ones.

Cable practices create not only a barrier to entry to new firms and programs, but also exert pressure on even successful independent incumbents – pressure that may lead independent program sources to exit from the market. News reports indicate that Oxygen Network sold itself to a large, integrated media company in part because of its inability as a stand-alone independent to secure enhanced carriage fees and wider distribution from integrated cable systems.[26] Independent programmers are also regularly offered the opportunity to sell their channels to integrated cable systems. Frequently these offers arise in the context of carriage renewal negotiations.

Independent program suppliers considering purchase offers from cable operators are between a rock and a hard place. The value of their assets depends critically on carriage agreements being denied by cable operators, who are in a position to capture increased values inherent in better distribution. Lack of distribution results in lower value of the programming assets to the independent. This fact gives rise to inclinations to sell by independents who make the very sensible judgment that the offer to buy tabled by the distributor may be more valuable on a risk-adjusted basis than holding out on the prospect of acquiring better carriage terms. This "squeeze" adds impetus to gradual exit of independent program providers and attendant long term erosion of diverse programs and program suppliers valued by consumers.

The imbalance of economic power between integrated cable operators and specialized, independent program suppliers underlies a third source of market failure from a consumers' perspective, namely the ability of one party literally to foreclose market access or practically dictate its terms. While clearly not free from rivals using other platforms, the record establishes that cable firms have that market power. Rivalry among alternative platforms exists, but is insufficiently robust to deny cable operators power over price of the output of cable services as well as over the price of programming inputs.

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[25] Letter from JC Watts, Black Television News Channel to Marlene Dortch, Esq,, Secretary, *In the matter: MB Docket No. 07-42, Development of Competition and Diversity in Video Programming Distribution and Carriage,* August 30, 2007, pp. 2-3.

[26] Bill Carter, *NBC Purchases Oxygen Cable TV Network for Women*, New York Times, October 10, 2007. http://www.nytimes.com/2007/10/10/business/media/10oxygen.html?_r=1&n=Top/Reference/Times%20Topics/People/C/Carter,%20Bill&oref=slogin . See also Rebecca Dana, *Paul Allen Was Catalyst for Oxygen Media Deal*, Wall Street Journal, October 10, 2007. Online at: http://www.freepress.net/news/26864

Competition is present, but imperfect and marked by a degree of market power substantial enough to be exercised to exclude rivals of operators' affiliated programming interests. We are not alone in finding the incentive and ability of integrated suppliers to discriminate in the program market in ways that disserve consumers. Several studies by independent sources have found a) the existence of market power, b) the incentive to exercise it, and c) its actual exercise by vertically integrated cable systems in their dealings with unaffiliated program suppliers.

In a recent report to the Chairman of the Senate Commerce Committee, the U.S. Government Accountability Office concluded: "…ownership affiliation does influence the carriage of networks, as both broadcaster and cable operator affiliation are associated with a greater probability of a cable network being carried on a cable franchise."[27] Further, "[O]perators were more likely to carry cable networks that were majority-owned by either cable operators or by broadcasters than to carry other cable networks."[28]

The authors of the GAO study (Clements and Abramowitz) reported that: "…vertically integrated cable operators may seek to limit competition in the upstream cable network market by refusing to carry cable networks that compete with the operator's affiliated cable network…the refusal to carry a competitive cable network would make it less competitive - perhaps by raising its average cost - with the affiliated cable network in seeking carriage on cable systems in other geographic markets."[29] The GAO analysts also found that cable operators were more likely to carry their own affiliated networks. Specifically, they found that an affiliated network is 27.8 percentage points more likely to be carried by the cable operator than an unaffiliated cable network and that cable owned networks are carried 72.4 percent of the time compared to 44.6 percent of the time for unaffiliated networks. While conceding the presence of some transactions cost saving, the authors found: "…foreclosure of competition…as independent cable networks are less likely to be carried than are affiliated networks."[30]

An even more recent FCC-sponsored study also found that vertically integrated cable systems are more likely to carry their own channels.[31] The FCC-sponsored study concluded further that there were no apparent economic reasons other than affiliation why this was true: "…the evidence at the network level gives little evidence that that

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[27] U.S. Government Accountability Office, *Issues related to Competition and Subscriber Rates in the Cable Television Industry*, Report to the Chairman of the Committee on Commerce, Science, and Transportation, U.S. Senate, October 2003, p. 5. Online at: http://www.telecommunityalliance.org/images/GAOcablerates03.pdf

[28] Ibid.

[29] Michael E. Clements and Amy D. Abramowitz, *Ownership Affiliation and the Programming Decisions of Cable Operators*, U.S. Government Accountability Office, p. 3. Paper presented at the Telecommunications Policy Review Conference. Online at: http://web.si.umich.edu/tprc/papers/2004/289/TPRC2004.pdf

[30] Ibid.

[31] Austan Goolsbee, *Vertical Integration and the Market for Broadcast and Cable Television Programming*, April 2007 (Paper commissioned by the Federal Communications Commission. Online at: http://www.fcc.gov/Daily_Releases/Daily_Business/2007/db0914/DA-07-3470A10.txt. The relationship was weakest in markets where there is intense competition from DBS.

vertically integrated networks attract more subscribers, grow faster, raise more ad revenue or licensing fees or have lower programming costs."[32] Similarly, Waterman and Weiss found that cable operators were more likely to carry affiliated pay cable networks and less likely to carry rival networks;[33] and Chipty concluded that vertically integrated cable operators were more likely to carry their affiliated networks and more networks overall. [34]

The Commission itself has found market power vested in cable companies and companion failure of market forces in protecting consumers. In its Adelphia Order, the Commission concluded that integrated cable operators have the incentive and ability to discriminate against nonaffiliated program suppliers. They did so in the context of finding with respect to regional sports networks (RSNs), that acquisitions of Adelphia assets by incumbent cable operators would increase their incentive and ability to deny carriage to unaffiliated RSNs. Specifically, the Commission found: "…post-transaction Time Warner and Comcast will have an increased incentive to deny carriage to rival unaffiliated RSNs with the intent of forcing the RSNs out of business or discouraging potential rivals from entering the market, thereby allowing Comcast or Time Warner to obtain the valuable programming for its affiliated RSNs."[35]

In this same context the Commission found significant harm to consumers from refusals to carry sports programming, inasmuch as: "…the programming provided by RSNs is unique because it is particularly desirable and cannot be duplicated."[36]

Finally, in the context of intermodal rivalry among cable, new digital media, cable, satellite broadcast television, and terrestrial television, Chen and Waterman, using the most recent data available, found: "…[V]ertical foreclosure [of unaffiliated programming] remains a persistent phenomenon in the U.S. cable television industry…"[37] Nor are consumers indifferent to this exclusion. According to Chen and Waterman: "Exclusion of rival networks reduces the amount and the variety of information that is available to the public."[38] Inasmuch as estimation by cable operators of the relative value of affiliated vs. unaffiliated programming is distorted by ownership considerations, the most likely outcome is that excluded programming will have higher value to consumers than that which is chosen for carriage by cable distributors. A market test would be conclusive, but such a test is foreclosed by cable market conduct.

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[32] Ibid.
[33] David Waterman and A. Weiss, *The Effects of Vertical Integration between Cable Television Systems and Pay Cable Networks*, Journal of Econometrics, *Vol. 72, pp. 357-395.*
[34] Chipty, T. *Vertical Integration, Market Foreclosure, and Consumer Welfare in the Cable Television Industry*, American Economic Review 91:3 (2001), 428-453.
[35] Adelphia Order, page 87, para. 189.
[36] Ibid.
[37] Dong Chen and David Waterman, *Vertical Ownership in Cable Television: A New Study of Program Network Carriage and Positioning,* Paper presented to the Telecommunications Policy Research Conference, September, 2006, p. 3. Online at: http://web.si.umich.edu/tprc/papers/2006/544/Chen-Waterman-Vertical%20integration-8-06.pdf
[38] Ibid.

Markets are clearly not working to achieve clearly articulated Congressional and Commission goals directed to preserving and promoting consumers' interest in diversity in program sources and programs. Despite the Commission's efforts to provide for resolution of conflicts through complaint, answer and reply processes, all reasonable indications are that improvements are needed. In the Notice to which these comments apply, the Commission recognized again its earlier finding that "the staff may be unable to some cases to resolve carriage agreement complaints on the sole basis of a written record."[39] There may be differences respecting the degree of, and sources for, infirmities in current processes, but there is little disagreement outside the cable industry with the American Consumer Institute's assessment that program carriage dispute resolution processes are simply not working.

III. CONCLUSIONS AND RECOMMENDATION.

The record makes clear: a) there are serious imperfections in video program production and distribution markets, b) market failures do now and will continue to impose costs on consumers, and c) customary government interventions (e.g., adjudicatory or regulatory remedies) are not adequate to protect consumers. Diversity and consumer choice in cable video programs are handicapped and indeed reduced substantially by market failures that are not fully offset by remedial FCC action.

In this context the Commission's task is to prescribe *minimalist* means of intervention that will effectively offset and largely eliminate barriers to realization of widely shared diversity goals. This implies putting in place processes that are more responsive to consumers' interests in timely and equitable resolution of conflicts that, unresolved, will continue to foreclose valuable consumer choice. Consumer sovereignty is now trumped by market gridlock caused by cable operator conduct. The goal of the Commission should be to compel private parties in carriage negotiations to act in ways more nearly consistent with consumers' interest.

We emphasize *minimalist* approaches that reflect Commission sensitivity to the costs to consumers and to the economy in general of administrative and regulatory procedures that provide the opportunity for powerful parties to seek private advantage, and impose public costs, by gaming regulatory processes. Despite good faith efforts by the Commission and its staff to fashion procedures availing fair opportunities for all parties, the fact remains that the current complaint process is expensive, rife with uncertainty and opportunities for self-seeking delay, stacked against small and minority enterprises, and otherwise not effective in protecting opportunities for independent programmers and the diversity consumers prefer.

The Commission has previously recognized procedural problems in an almost identical context and prescribed such a minimalist approach. In Adelphia, the

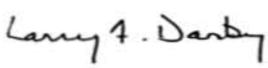
[39] See FCC 07-18, p. 5, citing Second Report and Order, 9 FCC Rcd at 2652. These perceptions are shared and in some cases magnified by programming interests. Commenters have expressed great dissatisfaction with the ability of the Commission to respond in substantive and timely ways to programmers' concerns. (Comments of NAMAC, p. 3)

Commission recognized conduct arising from market power unchecked adequately by competition. And, in order to prevent such behavior, the Commission adopted a condition "…requiring Comcast and Time Warner to engage in commercial arbitration with any unaffiliated RSN that is unable to reach a carriage agreement with either firm, should the RSN elect to use the arbitration remedy." That was the correct resolution for consumers there and it is the correct one here.

In consideration of the foregoing, we urge the Commission to act in the best interests of consumers and to extend the arbitration requirements adopted with respect to the Mid-Atlantic Sports Network and in the Adelphia Order. Such a requirement will allow parties unable, for whatever reason, to forge program carriage agreements in private negotiations to submit to *final offer* arbitration.

The template for such arbitration is detailed in the Adelphia order.[40] Respondents in this proceeding have suggested various safeguards and conditions for assuring that private parties, cable operators or independent programmers do not identify and exploit ways to game the process for private advantage paid for by consumers. The Commission should evaluate those suggestions, and adopt them or not, based on recognition of consumers' clear and strong preferences for more choice and diversity in cable programming, along with more certainty and less delay in bringing them about.[41]

Respectfully submitted,



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[40] See appendix B, Remedies and Conditions in FCC 06-105.
[41] We have not evaluated all the suggestions for amending the Adelphia rules, but believe that a reasonable starting point for Commission consideration would be those listed in the comments of TAC, p. 9.